



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

NOTES AND MEMORANDA.

A SUGGESTION ON THE TAXATION OF CORPORATIONS.

It is commonplace to say that in the working of the tax system of the United States the attainment of equality is the exception rather than the rule. Inequalities occur in the taxation both of individuals and of corporations, whether or not we regard interstate complications. To condemn this situation is quite as trite as to call attention to its existence. But perhaps a word may profitably be said (1) with regard to the concept ordinarily underlying current criticisms of the methods leading to these inequalities (and this with especial reference to the taxation of corporations) and (2) with regard to some practical problems upon which the examination of this concept may throw some light.

(1) The prevailing idea in this connection seems to be that ability or faculty is the test of equality in taxation; that equality of taxation is contingent upon equality of sacrifice on the part of tax-paying entities. As Professor Seligman has observed,¹ the history of finance shows a gradual evolution of the principle of faculty in taxation. Expenditure, property, product,—each in turn has been considered the test of obligation towards the state, until in modern times revenue or income has come to be regarded as the most equitable as well as the most practicable measure of faculty. Throughout the application of this notion to the solution of practical problems, the equality of sacrifice idea has been a prominent one; and, at least so far as concerns the taxation of individuals, its application would seem to be both helpful and suggestive. But in this com-

¹ *Essays in Taxation*, p. 21.

monly accepted form is it applicable as well to the taxation of corporations?¹

On its consumption side the faculty theory is relevant merely to conscious beings with wants and desires of varying degrees of urgency. A corporation is a fictitious personality, a mere legal entity. To ascribe to a thing possessing neither soul nor body any subjective experience in the shape of equality or inequality of sacrifice would be little short of ludicrous. To be sure, when a corporation pays taxes, it is not the association as such, but the individuals whose capital is invested that the state seeks to reach. But, entirely apart from the practical difficulty of reaching the investments of individuals for purposes of taxation, the fiscal test of ability must be applied not to segments, but to the entire incomes of individuals; and there is no necessary connection between the total earnings of a corporation and the total earnings of a shareholder. So that except as part of a system of taxation, which would reach all income and all other forms of property, any corporation tax would fall far short of measuring the tax-paying ability of share-

¹The following sentences from the excellent *Report of the Wisconsin State Tax Commission* for 1903, though apparently blind to the immediate significance of this question, are interesting:—

“The unmistakable importance of corporate taxation at this time renders the adoption of a rational, harmonious, and efficient system a prime necessity. The wealth of the country in personalty consists largely of investments in corporate securities, stocks, and bonds in railroad and other corporations which are not and cannot be reached for taxation to the holders by the severest and most inquisitorial laws. The taxation of corporations as legal entities is the only recourse, and therefore the method to be employed is of considerable significance.

“The highest authorities on economic and public finance are of the opinion that the problem of just taxation in this country is very largely the problem of corporate taxation.

“We may therefore ask, Does the license meet the requirements of a modern system of taxation, is it just and equal between the corporations, or between the corporations and the owners of real estate and personalty, and is it based on sound principles?

“The license fee on gross earnings to be permanently retained should have the unqualified approval of economic science as a just measure of ability to pay, and should also satisfy the legal conception of uniformity and equality which is the fundamental idea of constitutional government” (pp. 171, 172).

The hint that for purposes of taxation corporations should be regarded as “legal entities” is quite pertinent to our treatment particularly if its meaning be extended by implication to cover “industrial entities” or “productive units” as well.

holders. Indeed, it is on the production rather than on the consumption side that a solution must be sought for.¹

To set forth this view with clearness, an apparent digression must be made. From a certain standpoint the economic life of a nation may be regarded as a struggle for supremacy on the part of individuals, of industries, of associations, and of types of industrial organization. In this struggle, upon which economic progress is largely conditional and by which it is largely conditioned, the implied ideal of those who would interfere, whether through governmental intervention or otherwise, seems to be that of seeking to afford equality of competitive opportunity. And the ideal would seem to be an adequate one; for on any other basis the less efficient rather than the more efficient might gain the supremacy. Embodied in the common desire for an open field and a fair contest, it seems to be the central feature of current suggestions looking toward the elimination of a variety of industrial abuses. To illustrate: The solution of the railway problem turns upon the abolishing of rate discriminations. In the minds of many the solution of the trust problem (in so far as it is not a matter of discrimination in railway rates) hinges upon the prevention of discrimination in the charges made for trust products. "Collective bargaining" is but another name for the endeavor on the part of laborers to remove the element of inequality from their dealings with employers in the making of the wages-contract; and the labor problem itself is in essence the problem of preventing discriminations on the part of organized labor against unorganized labor and other productive factors. In short, the ideal of economic reform, and consequently of regulative interference on the part of government, is that of affording, throughout the field of economic activity, equality of opportunity.

The bearing of this test upon the special case of taxation is obvious. In a significant sense, taxation is an interference with industry. Taxes figure in expenses of production,

¹ Professor Seligman well indicates these difficulties in his *Progressive Taxation in Theory and in Practice*, Part III.

and a tax on one corporation relatively higher than a tax on another is equivalent to the placing of a handicap on the former in its competition with the latter. In a word,—avoiding complications by assuming proportion rather than progression to be the proper scheme of taxation, and leaving out of account other regulative and socializing ends in taxation,—the practical realization of our ideal would involve the adjusting of tax burdens with the aim of abstracting from the net incomes of various enterprises such proportionate sums as would leave those enterprises respectively upon the same relative planes of competitive efficiency as before the levying of such taxes. It ought to be recognized, at least as a theoretical possibility, that a discrimination in taxation, for instance, between two competing railways, may become the basis of variations in railway rates, and may reflect itself through a long line of charges for industrial services. To treat adequately of this possibility would involve a complete examination of the theory of railway rates and of the elements entering into other cases of price determination. To do this would require a volume rather than a couple of pages. It is enough here to make the observation that for the state to require equality in rates and charges under competition and at the same time to embody inequalities in its own exactions involves at least an inconsistency.

(2) Turning now to a brief view of practical considerations, it may be said that probably the greatest single influence leading to inequalities in the tax payments of different corporations is the present lack of uniformity in the tax practices of the States. For a long time past this has been particularly true of railway taxation, and it is becoming increasingly true of the taxation of all of those business organizations the activities of which overlap State boundary lines. Because of the desirability of attaining equality in railway tax burdens, where now exist great inequalities presumably because of the complete lack of uniformity in State methods, not a few have attempted to justify federal taxation as a substitute for or as a supplement to present

State arrangements.¹ A glance at the following table, which illustrates the situation among the most important roads in trunk-line territory, will tend to verify prevailing notions as to the character and magnitude of existing inequalities:—

Railway System.	Gross Income. ¹	Net Expenditures. ¹	Net Income. ¹	Taxes. ¹	Ratio of Taxes to Net Income. Per Cent.
Baltimore & Ohio:					
Group II. . . .	\$154,885,560	\$109,838,739	\$45,046,821	\$3,167,232	7.03
Group III. . . .	112,100,545	87,234,529	24,866,016	2,172,954	8.74
Total	\$266,986,105	\$197,073,268	\$69,912,837	\$5,340,186	7.64
Erie:					
Group II. . . .	\$169,896,422	\$118,399,100	\$51,497,322	\$4,355,565	8.46
Group III. . . .	68,740,580	55,190,172	13,550,408	1,836,670	14.29
Total	\$238,637,002	\$173,589,272	\$65,047,730	\$6,192,235	9.52
New York Central: ²					
Group II. . . .	\$335,907,945	\$242,552,815	\$93,355,130	\$14,047,904	15.05
Group III. . . .	332,929,364	250,292,075	82,637,289	9,040,803	10.94
Total	\$668,837,309	\$492,844,890	\$175,992,419	\$23,088,707	13.12
Pennsylvania:					
Group II. . . .	\$680,599,444	\$537,978,099	\$142,621,345	\$9,051,304	6.35
Group III. . . .	316,260,668	255,916,694	60,343,974	11,516,758	19.80
Total	\$996,860,112	\$793,894,793	\$202,965,319	\$20,568,062	10.13

¹Aggregate figures for 1897, 1898, 1899, 1900, 1901, and 1902, compiled from the statistical reports of the Interstate Commerce Commission, territorial groups II. and III. Net Expenditures represent total expenditures, less taxes and interest on funded and floating debt.

²Includes 380.04 miles of line (Michigan Central) not in the United States.

Any complex of tax devices under which it is possible for railway lines in adjoining States to be taxed respectively 6.35 per cent. and 15.05 per cent. of their net income is its own condemnation. Of course, it is only assumption to say that federal taxation would lead to any great improvement over present conditions; but the setting up of a single authority where there are now forty-seven would in itself seem to give this view at least the standing of a presumption. On the other hand, to assume that pre-

¹ See, for instance, Professor Seligman's testimony before the Industrial Commission, *Report of Industrial Commission*, vol. iv. pp. 600 *et seq.*, and an article by Professor H. C. Adams in *Review of Reviews*, February, 1899.

vailing inequalities constitute in themselves a sufficient ground for federal intervention would be somewhat rash; for certain additional considerations make the question a tolerably even one. Among these none has greater weight than the consideration that any move that would impede progress in the direction of a separation of the sources of State and local revenues is for that reason alone an objectionable one. A federal tax on interstate traffic receipts, by diminishing State and local revenues, would have this effect. On the other hand, the more expedient scheme of federal administration, coupled with apportionment, of a uniform tax on railway income, regardless of its interstate or infrastate origin, would avoid this objection. But even under this plan there would be numerous difficulties arising out of the knotty problem of apportionment, not to speak of the political and constitutional complications involved in a further extension of federal activities at the expense of the State governments.

But more than this: the same reasons that would justify federal taxation of railways would, if carried to their logical limit, justify federal taxation of industrial combinations and of other business organizations the operations of which extend beyond the confines of a single State. So large a proportion of the business of the country is now conducted by corporations, and so large a proportion of the corporations carry on their activities beyond the boundaries of a single State, that such a move would call forth in exaggerated form all of the objections that might be urged against the national taxation of the railways. Most radical of all the effects would be that upon the present balance between State and federal authority. But even here, should there take root the conviction that such a change of policy is in the main desirable, it would only be analogous to the view commonly urged in dealing with the trust problem,—that businesses which are national in their scope must be regulated, if regulated at all, by national authority.

ROSWELL C. MCCREA.